

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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CC:PSI:B01

PLR-137925-14

Date:

April 07, 2015

LEGEND:

X =

A =

Trust 1 =

Trust 2 =

Trust 3

State =

Court =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear

This responds to a letter dated September 29, 2014, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code

Facts

The information submitted states that X was incorporated under the laws of State on Date 1. Effective Date 2, X elected to be taxed as an S corporation. At the time of the election, A, an individual, held shares of X.

On Date 3, A transferred shares of X to Trust 1. Trust 1 was treated as an eligible shareholder of X under § 1361(c)(2)(A)(i). Pursuant to its terms, Trust 1 terminated on Date 4. Upon termination, Trust 1 provided that the entire remaining balance of Trust 1 including the X stock was to be divided into two and distributed to two trusts, Trust 2 and Trust 3. Trust 2 and Trust 3 were to be administered as provided in Trust 1's governing document. It was believed that Trust 2 and Trust 3 met the requirements of qualified subchapter S Trusts (QSSTs) under § 1361(d)(3) and QSST elections were filed for them as of Date 4. However, neither Trust 2 or Trust 3 was a valid QSST because their terms did not meet the requirements of § 1361(d)(3).

On Date 5, Court of State approved a petition to amend the governing document of Trust 1 *ab initio* to provide that, to the extent that X stock would otherwise be held by Trust 2 and Trust 3, the X stock would instead be held by separate trusts with provisions generally identical to those of Trust 2 and Trust 3 except that the new separate trusts (New Trusts) would include provisions to qualify New Trusts as QSSTs under § 1361(d)(3).

X represents that at all relevant times, X and its shareholders treated X as an S corporation. X represents that Trust 2 and Trust 3 have been administered as though the trusts were QSSTs since Date 4. X further represents that the termination of X's S election was inadvertent and was not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make any adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that a “small business corporation” means a domestic corporation that is not an ineligible corporation and that does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part 1 of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1361(d)(2), will be treated as a trust described in § 1361(c)(2)(A)(i) and the beneficiary of such trust shall be treated as the owner (for purposes of § 678(a)) of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary; the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken so that the corporation is a small business corporation; and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Rev. Rul. 93-79, 1993-2 C.B. 269, provides that a state court order that reforms a trust to meet the requirements of a QSST is recognized prospectively.

Conclusion

Based solely on the information submitted and the representations made, we conclude that X's S corporation election terminated on Date 4 when the X stock was transferred to Trust 2 and Trust 3 because Trust 2 and Trust 3 were ineligible shareholders of X. We further conclude that the termination of X's S corporation election constituted an inadvertent termination within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 4 and thereafter, provided that X's S corporation election was otherwise valid and has not otherwise terminated under § 1362(d).

This ruling is conditioned upon the X stock held by Trust 2 and Trust 3 being transferred to New Trusts and New Trusts filing QSST elections effective the date of the X stock transfer, with the appropriate service center within 120 days of the date of this letter. A copy of this letter should be attached to the QSST elections.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, we express or imply no opinion regarding whether X is otherwise eligible to be an S corporation. This ruling is directed only to the taxpayer who requested it.

Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Faith P. Colson

Faith P. Colson
Senior Counsel, Branch 1
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: